IN THE

Supreme Court of the United States

No. 249.

October Term, 1923.

THE YOUNG MEN'S CHRISTIAN ASSOCIATION, OF COLUMBUS, OHIO, BEREA COLLEGE, AND THE AMERICAN MISSIONARY ASSOCIATION,
Petitioners,

vs.

ORA DAVIS ET AL.,
Respondents.

BRIEF OF PETITIONERS.

FRANK DAVIS, JR.,
HENRY A. WILLIAMS,
GUY W. MALLON,
JAMES I. BOULGER,
Attorneys for Petitioners.

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(Direct and Reverse.)

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STATEMENT.

On May 21, 1923, this court, on application of petitioners, granted writ of certiorari to the Supreme Court of Ohio, and this case is now for hearing upon the merits.

The question for determination is the incidence of the federal estate tax paid by the executor of Mary J. Sessions, a citizen of Ohio. Mrs. Sessions died on April 1, 1919, leaving a last will and testament which was executed on September 17, 1914, prior to the enactment of the act giving rise to a federal estate transfer tax, and which was duly probated. In this will, after making certain specific devises and bequests, the testatrix provided by Item X:

> "All the rest, residue and remainder of my estate and property, real, personal and mixed, of every nature and description, or wheresoever situate, including any lapsed legacies of which I may die possessed, or to which I may be in any way entitled, I give, devise and bequeath to the Young Men's Christian Association, of Columbus, Ohio, the Young Women's Christian Association, of Columbus, Ohio, Berea College, and the American Missionary Association, to be divided equally among them share and share alike by my executor hereinafter named * * *." (R., 19.)

It is conceded that the institutions named in the foregoing item, as residuary legatees and devisees, are corporations organized and operated exclusively for religious, charitable and educational purposes, and neither the government nor any of the parties hereto deny that they come within the purview of *paragraph 3 of section* 403 of the federal estate tax law of 1918 authorizing the deduction of the value of the gifts received by them under the will from the gross estate, for the purpose of ascertaining the value of the *net estate*, upon the transfer of which the federal estate tax is imposed.

The executor named in the will deducted from the de-

cedent's gross estate the debts and charges and the amount of the specific devises and bequests for the purpose of ascertaining the value of the residuary estate. When the residuary estate had been thus ascertained, he then deducted from the entire estate the charges, debts and, in compliance with *paragraph* 3, *section* 403, federal estate tax law, the value of the residuary estate devised and bequeathed to the named charitable, religious and educational institutions, and also the exemption of $50,000.00 provided for in *paragraph* 4 *of section* 403 of the federal estate tax law, to determine the value of the net estate upon the transfer of which the tax was imposed under *section* 401 of the federal estate tax law.

It will thus be seen that it was correctly determined that the existence of the *specific devises and bequests gave rise to the tax.* After paying this tax, which amounted approximately to $31,000.00 upon the transfer of the specific devises and bequests, the executor brought an action in the Common Pleas Court of Franklin county, Ohio, for the purpose of obtaining the direction of the court whether the tax should be deducted from the *net estate* which went to the specific devisees and legatees, thus causing it to be taken from the aggregate amount going to the specific devisees and legatees none of whose devises and bequests were deductible from the gross estate under *paragraph* 3, *section* 403, or whether it should be taken from the residuary estate, which had been devised and bequeathed to the charitable, religious and educational institutions named in Item X, notwithstanding the fact that these residuary

devises and bequests were properly deducted from the gross estate for the purpose of arriving at the net estate upon the transfer of which the tax was imposed.

The Common Pleas Court held that the tax was to be treated as a debt of the decedent or of the estate and as such should be paid, as other debts, out of the residuary estate. Without discussing the law the Court of Appeals, while admitting that the question was not free from doubt, affirmed this judgment, and the Supreme Court of Ohio in turn affirmed the decree of the Court of Appeals. (Opinion, R. 4.)

THE STATUTE.

The earlier form of the statute must be ignored, as the provisions for the deductions that are here the vital and governing elements, were inserted, by amendment, in what is known as the revenue act of 1918, effective February 25, 1919, and which is the law under which the tax in question was imposed.

Section 401 of the federal tax of 1918 (40 Stat. 1096; section 6336¾b, United States Compiled Statutes, Supplement 1919), provides:

> "A tax equal to the sum of the following percentages of the value of the *net estate* (determined as provided in section 403) is hereby imposed *upon the transfer of the net estate* of every decedent dying after the passage of this act, whether a resident or non-resident of the United States;" (here follow the percentages).

Section 403 (40 Stat. 1098; section 6336¾d, United States Compiled Statutes, Supplement 1919) provides

for the determination of the value of the *net estate for the purpose of the act*, by deducting from the value of the gross estate:

(1) Amounts for funeral and administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate when not compensated for by insurance or otherwise, amounts reasonably required and expended for the support, during the settlement of the estate, of dependents upon the decedent, and exclusive of income taxes upon income received after the death of the decedent, or estate, succession, legacy or inheritance taxes.

(2) An amount equal to the value at the time of the decedent's death of any property which can be identified as having been received by the decedent as a share in the estate of one who died within five years prior to the death of the decedent, or acquired by the decedent in exchange for property so received, if the estate tax under the Act of 1917 or under the act under consideration is collected from the estate and is included in the decedent's gross estate.

(3) "*The amount of all bequests, legacies, devises or gifts* * * * *to or for use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes,* * * *."

Section 404 (40 Stat. 1099; section 6336¾c, United States Compiled Statutes, Supplement 1919) is important to consider as disclosing congressional intent. It provides:

"The executor shall * * * file a return * * * setting forth * * * (c) the value of the *net estate* of the decedent as defined in section 403; and (d) *the tax paid or payable thereon* * * *."

THE QUESTION.

The question for consideration is whether the federal estate tax, which is "*imposed upon the transfer of the net estate,*" may be paid out of the devises and bequests to corporations organized and operated exclusively for religious, charitable and educational purposes, when the statute imposing the tax expressly provides that such devises and bequests must be deducted from the estate, in order to arrive at the transfer which is taxed, and when, in determining the tax, the amount going to these institutions may not be considered. Did Congress intend that these bequests and devises should be deducted merely to reduce the tax and then be recalled for the purpose of paying the tax, or did it intend what the statute plainly provides, that the federal estate tax does not apply to bequests to charitable institutions—that such bequests are exempt from direct or indirect payment of, or contribution to, the tax?

That the question may not be obscured by extraneous issues, we desire to add that we do not contend that when the tax is paid out of *the net estate* it may not ultimately be taken from the residuary part of such net estate; nor do we urge that the tax must necessarily be prorated among the legatees taking the net estate as held in *Fuller v. Gale*, 75 N. H., 544.

SPECIFICATION OF ERRORS.

The fundamental errors underlying the decisions of the Ohio courts are:

(a) They treated the tax as a debt of the decedent, or of the estate, when it could be neither, as death being "the generating source" of the tax it could not be a debt of the decedent for it did not arise until her death; it could not be a debt of the *"estate"* for neither the existence nor the passing of the *"estate"* gave rise to the tax. It was not because the decedent left an estate that there was a tax, but because she transferred certain parts of it to the specific legatees and devisees—in other words *it was because she transmitted the net estate that a tax was imposed.* Had she left all of which she died possessed to the residuary legatees there would have been no tax because there would have been no estate.

(b) They entirely ignored the intention of Congress in enacting *paragraph* 3, *section* 403, federal estate tax law, which was clearly designed to relieve the institutions therein designated from direct or indirect contribution to the tax, *the incidence of which is placed upon the transfer of the net estate of which these residuary legatees and devisees took no part.*

(c) They also overlooked the fact that the construction by them adopted renders ineffective and meaningless *paragraph* 3 *of section* 403.

ARGUMENT.

The residuary legatees in this case contend that the federal estate transfer tax, being imposed upon the *transfer of the net estate,* must be collected *or taken from the net estate,* and, as their devisees and bequests *form no part of the net estate,* but on the contrary must be deducted from the aggregate estate before the transfer is taxed, the gifts to them cannot be diminished by or charged with the tax; that in providing for the deduction of such gifts before the value for transfer tax purposes is ascertained, Congress clearly intended to free such legacies and devises from contribution to the tax; and that *within the purview of the statute, the devises and bequests were never transferred, formed no part of the transfer taxed and had no existence under the taxing law—in other words Congress taxes no transfers to corporations specified in paragraph* 3, *section* 403, *and as the gifts to them are taken out of the estate for tax assessing purposes, they should not be brought back into it for the purpose of paying the tax.*

Thoroughly to comprehend the application of this act, it is important to understand its history and the underlying theory of taxation upon which it is based. This has nowhere been more clearly explained and keenly analyzed than in the illuminating opinion of Mr. Justice White in *Knowlton v. Moore,* 178 U. S., 41. No one can read this decision without coming to the conclusion that the tax under discussion is a *net estate transfer, rather*

than inheritance tax, and that *it is not* as the Supreme Court of Ohio assumed, *imposed upon the right of the decedent to transfer his property, but on the contrary is upon the transfer or transmission of the net estate.* Failure to recognize this distinction led the Ohio courts into the error of which we complain. To maintain that the tax is on the right of the decedent to transfer his property would render the act subject to constitutional attack, as the federal government does not grant this right and has no control over it. In fact this was a ground of attack on the law in *Trust Company v. Eisner*, 256 U. S., 345, and was urged against it by Messrs. Gleason and Otis, on page 554 of the second edition of their work on *Inheritance Taxation* wherein they say:

> "But the right to transfer at death is not a privilege bestowed by the federal government. It is not one of the powers delegated to Congress by the states in the national constitution."

Mr. Justice White demonstrates in *Knowlton v. Moore*, 178 U. S., 41, 58 et seq., that, while state taxes may be imposed upon the right of the decedent to transmit his estate, a federal tax is not upon the power of the state to regulate the devolution of property but is upon the transmission of the inheritance. In *Greiner v. Lewellyn*, 258 U. S., 348, it is said the federal government "has the power to tax the transfer of the net assets," which accurately defines the power exercised here.

Again, even if we assume that the tax is on the right of the decedent to transmit, *it is not upon his right to transfer his estate*, as the Ohio courts assume, that the

tax is based, *but rather upon his right to transmit his net estate.*

The correct theory of the tax is well stated in *Lederer v. Northern Trust Company,* 262 Fed., 52 (certiorari denied 253 U. S., 487) in the following language:

> "It concerns generally the federal tax, which both parties concede to be an estate tax, that is, a tax that relates not to an interest to which some person has succeeded by inheritance, bequest or devise, *but an interest which has ceased by reason of death; and it is imposed not upon the interest of the recent owner or upon his privilege to dispose of it, but upon the transfer of the interest in its devolution.*" (pp. 53, 54.)

The Tax Should be Deducted From the Aggregate Net Estate in its Devolution.

Section 401 imposes the tax upon the *transfer of the net estate and not upon the transfer of the estate generally;* therefore whether it be the power to transmit, or accurately speaking, the transfer of interest in its devolution, *we must look to the thing that the statute contemplates, as transferred, which is the net estate,* for the purpose of ascertaining the incidence of the tax. Congress did not intend to tax the transfer of one thing and require the payment of the tax out of something else.

By *paragraph* 3, *section* 403, Congress have provided that the "amount of all bequests, legacies, devises or gifts * * * to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes," shall be deducted from the gross estate in order to arrive at the

transmission tax. *The transfer of the interest in its devolution that is taxed is not what goes to these corporations, but what remains in the net estate.* Congress refused to tax the transmission of the estate to these institutions; the decedent may give them his whole estate, and there will be no tax upon the value of what they take. The federal estate transfer tax only becomes effective when the decedent goes further than to make gifts to such corporations and exercises his right and power to pass his estate to others; it is only in the latter event that the tax arises. What is no part of the net estate—the residuary devises and bequests here—is left out of consideration when the tax is levied and collected. To label these devises and bequests residuary and then to insist that because of this the tax must be taken from them, is to overlook the theory and purpose of the law and the intent of Congress.

The Net Estate, Giving Rise to the Tax, Should be Charged with its Payment.

As the transfer of the net estate gives rise to the tax it is only logical to assume that the *net estate* must be chargeable with its payment, *the existence of the rest of the estate is not recognized in the statute.* The tax being levied upon the devolution of this part, it alone should yield exaction to the government.

If the tax is upon the transfer, it should be taken from what is transferred within the meaning of the law, and not from something that Congress has expressly taken out of the transfer. Ultimately it must come (a) from

the transferor, which cannot here be the case because death being "its generating source" and the "transmission from the dead" being that on which the tax is rested (*Knowlton v. Moore, supra*, pages 56, 57) it cannot arise until the death of the transferor (*Hampton v. Hampton*, 188 Ky., 199, 202, 10 A. L. R., 515, 518), or (b) from the thing transferred or from the transferee. For convenience it is here taken out of the thing transferred, which of course is the net estate; and thus it eventually falls upon those who take *the aggregate net estate*—in other words as a charge against the net estate it is deducted before each individual secures his share of the net estate, differing in this respect from an inheritance tax where the tax is taken from the interest passing to the individual legatee.

The clearest and most graphic description of this tax is that given by the Supreme Court of Oregon in *Re Estate of Inman*, 101 Ore., 182, 16 A. L. R., 675, 199 Pac., 615, wherein it is said:

> "Every estate within the embrace of the federal statute must pass through the federal government's toll gate before it can be divided, and the several portions into which it is divided sent onward to their respective destinations. Figuratively speaking, this toll gate is erected and maintained *at the place where the net estate of the decedent is assembled* preparatory to its division and distribution; but, *before the net estate* can be divided and pass through the toll gate, a toll must be paid to the national government. *This toll is fixed and collected upon the assembled net estate considered as a unit*, without regard to the different portions into which it is to be divided, and without regard to the different roads over which the several portions are to go after passing through the toll gate, and without regard to the destination of the different portions."

Legislative Intent Expressed in the Act.

The manifest congressional intent is clearly expressed by *paragraph 3, section* 403, requiring the deduction from the gross estate of these devises and bequests. Originally the law contained no such provision and when this amendment was passed Congress must have contemplated that it would inure to the benefit of those specifically described and whose devises and bequests were to be deducted. The object of the amendment was to accord an exemption from the tax to institutions of the designated classes, and not to relieve legatees and devisees for whom no exemption was provided and gifts to whom were to remain within the net estate.

Opinion Supreme Court of Ohio.

This opinion will be found on page 4, et seq., of the record. As their premise the court assume that which is the real point in controversy, viz: that *the tax is a charge against the estate;* the purpose being, to use the words of the court, "to enact a revenue raiser, which should impose a charge or excise *upon the decedent's right to direct or control the transfer of his estate;*" hence "the *estate* must be considered as a whole without regard to the nature, character or amount of the legacies and bequests." The evident idea of the court was that, as the charge was upon the right to transfer, it must be a charge against the estate.

The fallacies underlying this concept are obvious:

(a) the charge is *not upon any right of decedent;* state laws may be upheld on this theory because the state confers or permits the exercise of this power by the individual, and Congress cannot constitutionally limit or interfere with this right of the state. It was upon the hypothesis assumed by the Ohio court that the inheritance tax of 1898 was attacked, and, in *Knowlton v. Moore,* 178 U. S., 41, this court demonstrated that the tax was not imposed upon the power of the state to regulate the devolution of the property but upon the *transmission* or receipt (*Greiner v. Lewellyn,* 258 U. S., 348). The same theory was made the basis of an attack upon the present law, as appears from the briefs in *Trust Co. v. Eisner,* 256 U. S., 345, and was evidently repudiated by this court; (b) even if the tax be upon the *right* of the decedent it is not upon his right "to control or direct the transfer of his *estate,*" for by its plain terms the law only affects *his right to transfer his net estate,* and therefore the tax should be deducted *from the net estate,* not the "estate."

The court refer to the will of the testator, but as there was no provision in the will, (which was executed before the passage of the statute) dealing with this tax, this element must be disregarded. (*Plunket v. Old Colony Trust Co.,* 233 Mass., 471, last paragraph.) While there may be a presumption, as the court say, that a specific legacy has priority over residuary devises and bequests, this doctrine obtains only where *charges against the entire estate* are being considered. Here we have a statute that fixes this charge *not upon the estate* but upon

the transfer of the *net estate*. It may be that *if the residuary bequests were part of the net estate the rule announced by the court would be applicable but such is not the case.*

The court regard it as "a strange legal paradox" to hold residuary devises prior to those that are specific. This we respectfully urge is not here the question. *The federal law has expressly conferred upon designated corporations the privilege of exclusion from the taxed transfer;* Congress must have intended by this to favor them, as they are usually the subject of legislative favor, and the only way in which this favor may be given effect is by freeing them from direct or indirect payment of the tax. Thus the question is not the priority of bounties, *but the effect of the statute in relieving prescribed institutions from the tax.* Shall a tax created by the transfer of a net estate, give rise to a charge that must be paid by those taking no part of the net estate? When Congress took these bequests from the net estate, they effectually freed them from the tax.

The court quote part of *section* 408 (40 Stat., 1110) but through inadvertence separate the quotation from its context by a period instead of a comma. This section provides for the collection of the tax and contribution from or marshalling of persons subject to equal or prior liability for the tax, "it being the purpose and intent of this statute that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before the distribution." (*Trust Co. v. Eisner*, 256 U. S., 347.) It is noteworthy that this

section recognizes that the tax is not ultimately to be assessed upon the *estate* because it provides for recovery of a proportion of the tax from beneficiaries of insurance policies, who would take nothing from what is legally understood to be the decedent's estate. It also connotes that there may be priority of obligation to pay the tax (*Hampton v. Hampton*, 188 Ky., 199; 10 A. L. R., 514). In any event it is but an administrative feature of the law to insure prompt and full payment to the government without compelling the treasury department to follow the property into the hands of the donees. (*Scholey v. Rew*, 23 Wall., 331, 347; *Re Inman*, 101 Ore., 182, 16 A. L. R., 675, 681; *Hampton v. Hampton, supra; Matter of Gihon*, 169 N. Y., 443, 447.) It certainly does no more than provide for the collection rather than the incidence of the tax. To require a tax to be paid before an estate is distributed does not fix, or even imply, which part of that estate should eventually bear the tax; that question must be determined from consideration of the provisions of the act creating the tax and providing for the deductions.

The cases relied upon by the court to sustain their view make clear the distinction that the court failed to note.

Re Hamlin, 226 N. Y., 407, and *Plunket v. Old Colony Trust Co.*, 233 Mass., 471, both arose under the act of 1916 and consequently the courts did not consider whether devises *that formed no part of the net estate* could be forced to pay the tax. All the courts held was that *when residuary bequests and devises were part of the net estate* the federal tax should be taken out of these

residuary gifts—a proposition we do not dispute. The New York court quotes Mr. Kitchen, who presented the statute to Congress, to the point "we simply levy on the *net estate*" and in the Massachusetts case it is said the statute "looks only to the net estate itself as defined," "an estate tax is levied upon the net estate transferred," which view is thus expressed in the later case of *Old Colony Trust Co. v. Treasurer and Receiver General,* 238 Mass., 544, 16 A. L. R., 689, 131 N. E., 321, 324; "such a tax is a charge upon the net estate transferred by death;" these quotations substantiating our view.

United States v. Perkins, 163 U. S., 625, was construed in *People v. Bemis,* 68 Colo., 48, as being applicable to the statute here under consideration because both used the words "imposed upon the transfer." The former recognized the right of the state to require contribution before a bequest could take effect. Apply that rule here and we find that the contribution is required of the *net estate before it may pass.* It is very clear, however, that the law there construed provided for an *inheritance tax,* and hence it would not here be applicable. *People v. Bemis* marks the distinction between estate and inheritance taxes, holding that the federal tax should be deducted before the state inheritance tax is computed. The question here raised was not before that court and does not even appear as *obiter* in the opinion.

Finally, if the instant decision is correct, *section* 403, *paragraph* 3, is meaningless, except merely to reduce the federal tax, (and in view of the history of the law was certainly not congressional intent) unless *the whole estate goes to the exempt institutions, which surely is not the only instance in which the exemption is to be effective.*

The Decision of the Courts Below Subverts the Intent Expressed in the Statutory Provision for Deduction of Legacies to Petitioners.

A careful study of the statute and the decision of the Supreme Court of Ohio demonstrates that if this decision be correct *paragraph* 3, *section* 403, providing for the deduction of these bequests from the gross estate, accomplishes practically nothing, except a reduction in the federal tax, *unless the whole estate goes to institutions described in paragraph* 3, *section* 403, which cannot of course be the case, as Congress would not pass an act that would only relieve these institutions from taxation when they received the whole estate and at the same time subject them to the tax when they received less than the whole.

In providing for these deductions Congress could have had only two objects, (a) to reduce the amount of the tax, which certainly was not designed, as it was the intent of the law to produce revenue and there could have been no purpose to reduce this revenue merely because there were devises and bequests to these institutions if the institutions were not to be the sole beneficiaries of the deductions; (b) to relieve these institutions from being called upon to pay the tax.

Under the Ohio ruling, of course if the whole estate went to these institutions there would be no tax, but this is the only case in which they would benefit by the statutory deduction. Take for illustration the present case: The deduction reduced the value of the net estate and, the

percentage being upon this, it is true that the tax is not so much as if the residuary estate did not go to these corporations, but this lessening of the tax is not the benefit intended to be conferred by Congress because the tax is on the transfer of the net estate and there has been no reduction of the tax but merely a diminution of the thing taxed. It is not because of the deduction that the tax is less but rather because the tax is based upon the value of the net estate of which these devises and bequests are no part. It has been said, however, that this suit must benefit the residuary legatees as they are not called upon to pay as much as if there were no reduction of the net estate. While this is in a sense true, it is not such real and direct advantage as Congress intended to confer upon them. Furthermore it is not an advantage peculiar to these legatees but may benefit others as well, as we shall hereafter show. *The object of Congress was entirely to relieve them from the direct or indirect incidence of the tax. To call upon them to pay the tax, whether it be large or small, frustrates this obvious intent.*

One only carries the argument of opposing counsel to its logical extent when we illustrate with a case *where specific devises and bequests are to charitable institutions and the residuary estate goes to others whose legacies and devises are not deductible.* In this case the residuary legatees pay a tax, but that tax is much less than it otherwise would be because the devises and bequests to the specific legatees and devisees are deductible, thereby reducing the value of the net estate and the tax.

It will thus be seen that the mere reduction in tax, following the argument of opposing counsel, inures to the benefit of those called upon to pay the tax, whether they come within the provisions of *paragraph 3 of section* 403 or whether they do not; hence the mere fact that the tax is lowered by reason of the deduction cannot be said to be a distinctive benefit to the charitable institution because such benefit may inure to others, dependent upon whether they are specific or residuary legatees, which should disclose that the mere fact that the tax becomes smaller because of this deduction is no reason for asserting that Congress thereby exclusively benefit the charitable institution; and it also makes patent the fact that Congress must have intended something different from this by providing for this deduction, as, *when corporations of the class of petitioners were specifically singled out and distinguished in the statute, this was for the purpose of according them an advantage not shared by those not classified with them.*

It is quite true that under the Ohio ruling corporations described in *paragraph* 3, *section* 403, would not be called upon for the tax if their legacies were specific and the legacies comprising the net estate were residuary, but, according to the reasoning of the court, this does not follow from the law but because of the holding of the court that the residuary estate, rather than specific legatees, should pay; if this is true, then the provision for deduction would be unnecessary to relieve these institutions from the tax in this instance because they would be relieved anyhow. Upon the hypothesis of the Ohio courts,

paragraph three would accomplish nothing in such cases, and would be of no significance.

If the entire estate were specifically bequeathed, the tax, under the Ohio ruling, being a charge against the general estate, would be deducted from the entire estate and consequently it would diminish the share of each legatee. If half of such an estate went to institutions described in *paragraph* 3, *section* 403, the net estate would be thereby reduced and the tax lowered, but nevertheless, in the final analysis, these institutions would pay one-half of this tax and the other non-exempt legatees would pay the other half, if the tax were a charge against the entire estate; consequently the latter class would have their share of the tax lowered to the same extent as would the charitable institutions, which again develops that, by the Ohio doctrine, the benefits of *paragraph* 3, *section* 403, *are not confined to the corporations therein named but are shared equally with others.* Congress did not intend that, by providing these deductions, the advantages thereof should be shared by others than those included within the described classes. There was no design to reduce the tax that would ultimately come from gifts to those whose legacies and devises were not deductible from the net estate.

If what went to these corporations in the foregoing illustration had been specifically given to those not described *in paragraph* 3, then the net estate would be larger and the tax higher; and the proportionate share of the legatees in the tax would be the same although the actual amount taken from each share would be larger;

consequently the government would receive a greater tax. Yet, when we consider the non-exempt classes, there is no reason why Congress would require a larger contribution from them in the one case than in the other, *as their individual situation would be the same in each instance.* Why would Congress provide that the individual should have his share in the estate reduced to a lesser extent merely because he was named as joint legatee with a corporation operated for charitable, religious or educational purposes? Why would governmental revenue be reduced when the reduction would benefit those whose devises and bequests could not be deducted from the estate for the purpose of reducing the tax?

Assume that part of the residuary estate here went to non-exempt classes; that part taken by petitioners would reduce the tax, by lessening the net estate; yet both deductible and indeductible legacies must bear their proportionate share of the tax. Here, again, we should have a reduction of tax that would inure to the benefit of those for whom Congress had provided no exemption.

For final illustration on this point, let us give consideration to the view of the government, in *Edwards v. Slocum,* 287 Fed., 651, that there can be no ascertained residuary estate until the estate tax is paid, and therefore, as the tax must come from this residuum, the residuary legatees do not get the tax and the *amount deducted* under paragraph 3 *should be the residuary estate less the tax, or what they actually received;* otherwise the tax is deducted from the estate in order to estimate the tax, which is contrary to the law.

If this view be correct it will be observed that in the instant case the net estate must be increased by the amount of the tax, because the deduction on account of these devises and bequests must be reduced by the tax taken from this part of the estate, consequently the tax is increased. If what went to the residuary devisees and legatees had been specifically devised and bequeathed and the residuary estate had gone to the specific legatees and devisees, the net estate would have been the sum of these residuary legacies and devises and the tax would be estimated on this amount. As the tax would not come from the share of these corporations, the full sum going to them would be deductible without any increase of the net estate, and the tax would not thus be increased.

It will thus be seen that when the tax comes from the residuary estate, *it is larger when the residuum goes to charitable institutions than when it does not, and hence if such institutions take the residuary estate they would pay more than would individuals taking the residuary estate, where the gifts to charity were specific; and this even though the estate were of the same size and, without considering the tax, individuals and charities received the same amount in each instance.*

Significance of Imposition on "Transfer of the Net Estate,"

We must be mindful of the fact that the "transfer of the net estate" is the subject of the tax and that Congress must have intended by requiring the deduction by the amount of these devises and bequests, in order to

arrive at the net estate, that some exclusive and peculiar advantage should result to the legatees and devisees whose shares were thus to be deducted. Such advantage can only ensue if the tax comes from the net estate. By imposing it on the transfer of the net estate, those whose gifts are deducted must be considered as being without the purview of the law, and their interests have no existence for any tax purpose. No inconsistency, discrimination among the same classes, or anomaly follows our interpretation, because if the tax is taken from the net estate in the aggregate, we shall always have not only a fixed net estate but we shall consistently have contribution from this net estate and from nothing else.

Interpretation Given Statute to be Avoided as Involving Inconvenience and Inequality.

It has been pointed out in *Knowlton v. Moore, supra,* that a construction of a statute occasioning great inconvenience, injustice or inequality must be avoided. Yet the interpretation of the Supreme Court of Ohio will result in numerous anomalies among which we may mention:

(a) Had plaintiffs in error received the entire estate, there would have been no net estate transferred and no tax, and yet because others have been provided for by the testatrix, plaintiffs in error must pay a tax;

(b) if the legacies were all specific and none to exempt corporations, the net estate would be larger and the tax proportionately higher because of the progressive rate, than if half went to such exempt corporations, in which

event these exempt corporations would pay one-half the tax. This shows that estates of the same value would be differently assessed and that, after lessening the net estate, because of paragraph 3, the charitable institutions would be called upon for a tax imposed upon the transfer of the half they did not receive, i. e. *the net estate.* The same inconsistent results follow if the residuary estate on the one hand goes to those whose bequests are part of the net estate, and on the other, partly to such persons and partly to charitable institutions;

(c) not only is the amount of the tax different in each of the foregoing cases but the specific legatees named in a will containing specific bequests to charity pay less than do legatees receiving the same amount under a will containing no legacies to charity but disposing of an estate to favor a legatee merely because he was named in a will of the same value. Congress could not have intended containing charitable bequests.

(d) If conditions were reversed and petitioners took specific legacies and the specific legatees the residuary estate, the latter would pay less than is demanded from the petitioners, if the contention of the government in *Edwards v. Slocum* is correct.

(e) All of the objections to the governmental view, which were the real basis of the decision in *Slocum v. Edwards, supra,* disappear, if our interpretation be adopted.

None of these inconsistencies follow the adoption of the construction for which we contend, because under it the tax is imposed on the transfer of the net estate and

must come out of this in its devolution. Hence the incidence of the tax is upon the net estate from which it must come. All net estates of equal value will pay the same tax, which harmonizes with the language and intent of the statute and the net estate is the object of the tax. It does not call for deductions to estimate the tax and then require that the tax shall be taken from these deductions which are treated in the act as no part of the transfer but which it is insisted should by construction be made part of the estate to pay the tax originating on another part. Nor does it call for the application of abstruse algebraic formula to estimate the tax, which was urged upon the court by the government in *Edwards v. Slocum,* 287 Fed., 651, and of which the court said: "Congress intended a simpler method—one that a plain man could understand. Algebraic formulae are not lightly to be imputed to the legislators." (p. 654.) If the tax be taken from the aggregate net estate, this question cannot arise as the charitable donations go to the legatees without reduction on account of the tax, and hence the amount they receive is not an uncertain sum; nor is the net estate "to receive augmentation by an unknown amount which renders its own figure unknown" (p. 653); that is if the tax comes from the deductible gift that gift is reduced by the tax, and the deduction thereby reduced, which again increases and so on *ad infinitum,* which, say the court, "baffles arithmetic" and requires "algebraic formulae."

Fallacy of Contention that "Net Estate" and "Value of Net Estate" Embrace Different Elements.

Realizing the inconsistency of imposing a tax on the transfer of the net estate and then taking the tax from what is no part of the net estate, opposing counsel argued in the Ohio courts that the tax is based upon the "*value*" of the net estate and that "*net estate*" and "*value of the net estate*" are composed of different elements; that by "net estate" Congress refers to the net estate known to common law which would include gifts to institutions mentioned in *paragraph* 3, *section* 403, and upon the transfer of this imposed the tax; while "value" of the net estate is an arbitrary thing designed for tax computation purposes. The answers to this are obvious:

(a) Congress used the word "*value*" in *section* 403 because, to apply percentages there must be reduction to a monetary basis in order to make the law convenient of operation—the government wants no division in kind; no percentage of stock, cattle, horses, swine and real estate, but cash.

(b) Why would Congress impose a tax on the transfer of the net estate and then apply its tax percentages to an arbitrary valuation that would not include the property comprehended within the term "net estate"?

(c) That Congress intended that the words "net estate" should mean what is left after making the deductions called for by *section* 403 is apparent from the language used in fixing the progressive per centum in *section* 401, wherein it deals expressly with a designated

per centum *"of the amount by which the net estate exceeds" a specified sum.* Note that here Congress speaks of the net estate and not the value of the net estate; had it been the intention to distinguish between value of the net estate and net estate it is manifest that Congress would have here used the word "value," instead of which the two expressions are used interchangeably when it is possible intelligibly to do so.

(d) If opposing counsel were correct then we should find this absurdity and inconsistency in the first sentence of section 401, (a) the percentage would be upon a value obtained by deducting the charitable bequests, but (b) the tax would be upon the entire estate less the charges. If the estate after the charges were paid were $1,000,000 which went to a charitable institution, there would be no basis for a percentage, but yet, as the tax is imposed upon the transfer of the net estate, which counsel say includes the charitable bequest, it must follow that this transfer should then be taxed; thus under one clause there must be a tax while under the other there is no way of estimating the tax. If the net estate must include the charitable bequest then, to use the foregoing illustration, we should have a $1,000,000 net estate upon the transfer of which no per centum could be figured.

(e) Further demonstrating that such is not the effect of the law we have but to examine the act of 1921 (*section* 400), wherein it is provided:

> "The term 'net estate' means net estate as determined under the provisions of section 403."

There has been no change in theory, principle or practical operation of the tax between the acts of 1918 and 1921, the salient language being in all essential features the same; hence there can be no doubt that "net estate" includes the same property, and that alone, upon which the "value of the net estate" is based. Subsequent legislative interpretation is entitled to weight:

Bowling v. United States, 233 U. S., 528-535, 536;
New York P. & N. R. Co. v. Peninsular Produce Exch., 240 U. S., 34-39.

Holdings that Tax is Deductible from the Net Estate.

While the question has not been directly decided, nevertheless the language of the state courts in discussing the federal estate tax seems to be directly in point in principle.

In *Re Miller*, 16 A. L. R., 694, 195 Pac., 413, it is said that the federal statute "entitles the tax 'an estate tax' and in terms *imposes it upon the net estate of the decedent as a unit.*"

In *Bugbee v. Roebling*, 94 N. J. Law, 438, 111 Atl., 29, it was held that in ascertaining the state tax the amount of the federal tax must be deducted. In this case Judge Bergen, in concurring, speaks of the federal tax as "the amount assessed by the officers of the federal government as a tax for death duties, *because the net estate to be distributed is reduced to that extent.*"

In *Ebersole v. McGrath*, 271 Fed., 995, Judge Peck, in discussing the inapplicability of the tax to property passing under appointment by donee of a power, says of the federal net estate transfer tax:

"The net estate only is its object." (page 1000.)

In *Old Colony Trust Co. v. Treasurer and Receiver General*, 238 Mass., 544, 131 N. E., 321, 16 A. L. R., 689, it is said on page 324 (N. E. Report), in discussing the federal estate tax:

> "In its nature such a tax is a *charge upon the net estate transferred by death.*"

In *Corbin v. Townsend*, 92 Conn., 501, 103 Atl., 647, the court considered the question of the right to deduct the federal tax and taxes paid in other states from the estate before computing the Connecticut succession tax, holding that such taxes were properly deductible before estimating the Connecticut tax. In the opinion the court say:

> "The federal act of 1916 imposes a tax payable out of the estate before distribution, thus differing from the federal inheritance tax of 1908, payable by the individual beneficiaries. It is not a tax upon specific legacies nor upon *residuary legatees. It is taken from the net estate* 'before distributive shares are determined rather than off the distributive shares.'" (page 505.)

In *State v. First Calumet Trust & Savings Bank*, 125 N. E., 200, 71 Ind. App., 467, 471 (1919), the state appealed from a judgment assessing the state inheritance tax after deduction of debts and the federal estate tax. In affirming the lower court the Appellate Court say of the federal tax:

> "The tax paid to the federal government *upon the net estate* before distribution cannot in any sense be held to have been part of the respective legatees or distributees, and the market value of such beneficial interest must of necessity be the value after deduct-

ing the federal tax, *the same having been deducted from the net estate* before distribution was made thereof, and it necessarily follows that the state inheritance tax should be computed after deducing *from the net estate the amount of such federal estate tax.*" (page 202.)

The opinion of the Orphans Court approved and appearing in *Re Knight's Estate*, 261 Pa., 537, 104 Atl., 765, holds, in allowing the deduction of the federal tax before ascertainment of the state inheritance tax:

"It [the federal estate tax] is denominated an estate tax, not a tax upon the succession or inheritance, and *it is charged upon and payable out of the net estate of the decedent.*" (page 538.)

In *People v. Pasfield*, 284 Ill., 450, the court, in deciding that the federal estate tax of 1916 must be deducted before computing the state inheritance tax, say that the federal estate tax

"levies a duty, as above shown, *on the entire net estate* before any distribution is made to the legatees or distributees."

In *Hampton v. Hampton*, 10 A. L. R., 514, 188 Ky., 199, 202, 221 S. W., 496, the court in holding that the federal estate tax does not affect the portion of an estate going to the widow under the laws of the state and that the estate tax was not payable solely out of the personal property, say:

"*The tax is imposed upon the net estate.*" (page 516, A. L. R.)

Distinction Between Decisions Relied Upon by Opposing Counsel and Case at Bar.

It has been urged, and the Supreme Court of Ohio takes the view, that *Hamlin v. Wellington*, 226 N. Y., 404, and *Plunket v. Old Colony Trust Company*, 233 Mass., 471, are in point. Neither of these cases has any pertinency as will appear from an analysis.

Hamlin v. Wellington, 226 N. Y., 404, 124 N. E., 4, presents a situation wherein the federal act of 1916 governs, as the decedent died on January 3, 1917, which was before the federal estate tax law was amended. As a consequence of this the foregoing case did not involve a consideration of the payment of the federal estate tax by residuary legatees or devisees *whose bequests and devises were to be deducted from the gross estate* in order to arrive at the net estate. In other words when the facts arose on which the New York decision was predicated, charitable, religious, scientific, literary and educational bequests and devises were not to be deducted from the gross estate in order to ascertain the net estate on the transfer of which the federal tax is levied. All that the court held in this case was that when the residuary devises and bequests *were part of the net estate, the federal estate tax should be paid out of the residuary part of this net estate.* An examination of the case will disclose that the question we here make did not arise and could not possibly have arisen because not only was the statute different from the one governing the instant case but the residuary legatees and devisees did not even

come within the class whose devises and bequests are to be deducted under the present law. We call attention, however, to the history of the original act as it appears in the opinion in this case and especially to the language of Mr. Kitchen, the chairman of the committee recommending the bill, who said:

> "We do not follow the beneficiaries and say how much this one gets and that one gets, and what rate should be levied on lineal and what on collateral relations, *but we simply levy on the net estate.*"

This language sustains our position that the tax being levied on the net estate it must be payable out of the net estate—in other words, when a tax is levied on a particular estate it must be paid out of that estate. Of course the statement of Mr. Kitchen is not quite accurate because the levy is on the transfer of the net estate rather than on the net estate itself, but it makes clear legislative intent that the tax should come from the aggregate net estate before its distribution. When the court uses the language that the tax is "payable by the estate," it unquestionably means that it is payable by the estate upon the transfer of which it is levied, viz., the net estate; furthermore when this case was decided there was not the same difference between estate and net estate as exists in the law under consideration.

Plunket v. Old Colony Trust Company, 233 Mass., 471, 124 N. E., 265, is distinguishable on the same grounds as is *Hamlin v. Wellington, supra.* The decedent died on October 25, 1917, and the bequests and devises were not to charitable, religious, scientific, literary or educational

institutions. In the Massachusetts case the court distinctly states that the tax is imposed upon the transfer of the net estate and uses the following very significant language:

> "The statute ignores utterly the disposition made of the estate by the testator or by the law as to intestate property, *and looks only to the net estate itself as defined.*"

It is pointed out that the words "net estate" are used uniformly in the operative parts of the act to the exclusion of phrases of other significance. It is also said:

> "An estate tax is imposed upon the net estate transferred by death."

The later case of *Old Colony Trust Co. v. Treasurer and Receiver General, supra,* reiterates this doctrine.

It will be seen from an analysis of the two foregoing cases that the question there arising was whether the estate tax was on the particular devises, bequests or distributive shares or upon the net estate, and that the courts in taking the latter view made no ruling that is pertinent to the case at bar, but apparently recognized the doctrine for which we contend, viz., that this tax should be payable out of the net estate, and *when part of that net estate* went to residuary legatees and devisees then the payment of the tax should come out of such residuary devises and bequests rather than from the specific devises and bequests; but it must at all times be borne in mind that this was only true *because the residuary legatees and devisees received part of the net estate.*

Much stress has been laid by opposing counsel upon

Re Newton's Estate, 74 Pa. Super. Ct. Rep., 361, which is readily distinguishable from the instant case in that it arose under the act of 1916 where there were no such deductions as are authorized under the law the court here is construing. It is interesting to note that in principle it follows our theory. The court says "*the tax* imposed by this statute is an exaction by the sovereign *to be taken out of the net estate*" (page 372) it was the intent "to impose the tax *upon the entire net estate;*" the lien upon the gross estate "*was an administrative feature introduced for the purpose of making certain the payment.*" (page 371.)

Lien Upon Gross Estate and Payment by Executor do not Affect Incidence of Tax.

Opposing counsel assert that because there is a lien upon the gross estate for the payment of tax and because it is paid by the executor, it may be treated as a charge to be borne as a debt of the entire estate. It is interesting to note that this theory was urged and the same sections (sections 407-409, *federal estate tax*) cited to the court in *Re Newton's Estate, supra*, to support the view that "the burden must be borne by all the legatees;" and in answer to this the court correctly replied: "that was an administrative feature introduced for the purpose of making certain the payment."

See likewise *Scholey v. Rew*, 23 Wall., 331, 347, construing a succession tax law providing for a lien upon land, the court saying:

> "Nor is the question affected in the least by the fact that the tax or duty is made a lien upon the land,

as the lien is merely an appropriate regulation to secure the collection of the exaction."

To the same effect is *State ex rel. v. Bonding Company*, 16 Ohio N. P. (n. s.), 497.

In discussing this question as presented by the federal estate tax law it is said in *Re Inman*, 101 Ore., 182, 192, 16 A. L. R., 675, 682:

> "Nor is such a tax necessarily made a direct tax on property merely because the statute provides for a lien upon property and requires payment by the executor or administrator, as *such provisions are nothing more than appropriate regulations to secure the collection of the tax.*"
>
> *Hampton v. Hampton*, 10 A. L. R., 514, 517, 188 Ky., 199, 202;
> *Matter of Gihon*, 169 N. Y., 443, 447.

Ohio Law Prescribing Payment of Debts of Decedent Inapplicable.

It has also been argued that the question must be determined by the law of Ohio, as Congress only requires payment by the executor and does not concern itself with the ultimate incidence of the tax. *This entirely overlooks the fact that in amending the original act, Congress expressly provided for deducting certain gifts from the gross estate in order to fix the net estate, the transfer of which is taxed.* In imposing the tax on the transfer of the net estate and in requiring the deduction of these residuary devises and bequests from the net estate, Congress gave certain legal effect to its language and impressed character upon the taxing law. *The effect of*

this amendment was to require the deduction of the tax from the net estate and to free the charitable institutions from contribution to its payment. This being the purpose of the act, no state can legally override such purpose by requiring payment from those whom Congress exempted from contribution to the tax.

It is also urged that the will provides: "all my just debts be paid" and this includes the tax. When the testatrix made her will there was no such tax. As we have pointed out it could not be her debt as it did not arise until her death, because a tax is not a debt (*Peter v. Parkinson*, 83 Ohio St., 36, 47; *State v. Harbeck*, 232 N. Y., 71), *nor is the federal estate tax a debt* (*Hampton v. Hampton*, 188 Ky., 199, 202, 10 A. L. R., 514, 518). In addition, it is not because the decedent leaves an estate that there is a tax *but because he transfers a net estate;* if there is no net estate there is no tax, therefore how can it be an *"estate"* debt? In *Plunket v. Old Colony Trust Co., supra*, relied upon by opposing counsel, it is said:

> "The will and codicils of the testator contain no direction respecting the payment of this tax. There is nothing written in any of these testamentary instruments which rightly can be construed as expressing the purpose of the testator on the subject. * * * It is not permissible for us to speculate as to existence of an intent * * * in the absence of any expression of testamentary purpose on the subject."

Some reliance has also been placed on *section* 10714 *General Code of Ohio*, providing for the order in which decedent's debts are to be paid, but as has been said, this was not a debt due from the decedent. All this is imma-

terial, however, because *this statute determines only the order of payment of debts and cannot possibly affect a federal statute creating a tax and providing for exemption from its incidence; it is the federal law that gives rise to the tax and by which its effect is to be determined. This statute requires the tax to come out of the net estate and no state law can change its incidence, or require it ultimately to be taken from what is no part of the net estate.*

The insistence that the tax is an administrative charge, is in conflict with the statute, which provides that the tax may not be deducted in arriving at the net estate. (Last line, *paragraph* 1, *section* 403.) Even before this language appeared in the act this was the rule:

> "The Federal estate tax is not determined, does not attach and cannot be assessed or paid until the net estate upon which it is based has been exactly determined. The estate tax, therefore, cannot be deducted from the gross estate to determine the taxable net estate."
>
> *Estate Tax Regulation* No. 37, Art. XXI (Corporation Trust Co. War Tax Service, 1919, p. 23).

If the total amount that would have gone to the residuary legatees, if the tax had not been taken from them, be deducted from the gross estate, and if the tax is taken from the residuary estate, it must follow that the tax is deducted because it is included within the aggregate deduction, which of course is plainly in violation of the statute.

Upon the whole it appears to us that Congress, in pro-

viding for the exclusion of the gifts to petitioners from the net estate, intended that these gifts should not be diminished by having the tax taken from them, and that no general rules of law authorizing the payment of debts from the residuary estate can be effective to detract from or modify the federal statute so clearly designed to free the residuary estate from this exaction, when that estate goes to those described in *paragraph* 3, *section* 403. The sole question here is the effect and meaning of a federal statute, thus presenting a federal question which cannot be eliminated or overridden by state statutes or state rules of law.

Respectfully submitted,

FRANK DAVIS, JR.,
HENRY A. WILLIAMS,
GUY W. MALLON,
JAMES I. BOULGER,
Attorneys for Petitioners.